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Supreme Court of the United States

October Term, [illegible]

No. 724

KOHINOOR COAL COMPANY,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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October Term, 1949.

No.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioner respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit, reported in 171 Fed. 2nd 880, which affirmed a judgment of the Tax Court of the United

States, reported in Vol. 6 C. C. H.—Tax Court Memo. Decisions, page 1078 (R. 8a-10a).

1. SUMMARY STATEMENT OF MATTER INVOLVED.

The question presented is whether the petitioner is entitled to an allowance for percentage depletion with respect to its operations in the extraction and processing of coal from coal or culm banks, which is leased from the owner of an underlying coal mine. The claim for depletion allowance is based upon Sections 23 (m) and (n); Section 114 (b) (4) (A) and (B), as amended, of the Internal Revenue Code.

The taxpayer is a Pennsylvania corporation, which entered into an agreement with Turkey Run Fuels, Inc. on February 11, 1941, whereby it leased from Turkey Run Fuels, Inc., the owner of a coal mine, certain coal or culm banks located on the surface of the mining property. The coal or culm banks had been placed upon the surface of the mining property by Turkey Run Fuels, Inc., the owner and/or its predecessors. The lease was to run for ten years or a shorter period if the marketable coal was earlier exhausted from the banks. Petitioner was to pay royalties to the owner of the coal mine of from ten to fifteen percent of the gross sales price of the coal at the mine (R. 19a) with a minimum rental of $24,000 per year (R. 18a) and was given the right to remove all coal from the coal banks located on the surface of the mining property. The Petitioner, in order to extract the coal from said banks, and to wash, size and load it for shipment, erected an anthracite breaker and installed other equipment and machinery at a cost to it of approximately $150,000. It then proceeded with the operations enumerated during the taxable years.

The Commissioner refused to allow petitioner any deduc-

tion for percentage depletion for the years ending June 30, 1943, and June 30, 1944. The Tax Court upheld the Commissioner and the United States Court of Appeals for the Third Circuit affirmed the Tax Court.

The Commissioner contends (1) a culm bank is not a "mine"; (a) extraction of coal from a culm bank is not "mining"; and (3) there is absent the requisite "economic interest" for depletion allowance.

The taxpayer takes the position (1) whether a culm bank is or is not a "mine" is immaterial, since Turkey Run Fuels, Inc. is the owner of the underlying coal mine and the coal on the surface came from the underlying coal mines; (2) extraction of coal from a culm bank is "mining", since Congress, in amending Section 114 (b) (4) by adding paragraph (b), broadened the definition of the word "mining" as follows:

> "The term 'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term 'ordinary treatment processes', as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing and loading for shipment; * * *."

and (3) it has the requisite "economic interest" since it alone has the right to remove all the coal from the culm banks.

2. STATEMENT AS TO JURISDICTION OF THE SUPREME COURT OF THE UNITED STATES.

(a) Nature of the Case; Statutory Provision and Cases Believed to Sustain Jurisdiction:

The judgment of the United States Court of Appeals for the Third Circuit, which petitioner endeavors to have examined and reversed here, holds that petitioner is not entitled to a deduction for percentage depletion on the sale of coal removed from a coal bank located on the surface of a coal mining property.

The jurisdiction of the Supreme Court of the United States is invoked under Section 237 (b) as amended, of the Judicial Code (28 U. S. C. A. 344 (b)).

The cases relied upon to sustain jurisdiction are:

Kirby Petroleum Co. vs. Commissioner (1946), 326 U. S. 599, 66 S. Ct. 409;

Palmer vs. Bender, 53 S. Ct. 225, 287 U. S. 551;

Lynch vs. Alworths-Stephens Co., 45 S. Ct. 274, 267 U. S. 364.

(b) Sections of the Internal Revenue Code Involved:

The statutory provisions involved in the appeal are found in paragraphs (m) and (n) of Sec. 23, and paragraph (b), subparagraph (4) (A) and (4) (B) of Section 114 of the Internal Revenue Code, Title 26 U. S. C. A. Sub-paragraph (4) (B) of paragraph (b) of Sec. 114 was added by Sec. 124 (c) of the Revenue Act of 1943, and is as effective as though it were in the revenue laws applicable to all taxable years beginning after December 31, 1931.

Section 23, in force for the taxable periods here involved, insofar as pertinent, is as follows:

> "Section 23. Deductions from Gross Income. In computing net income there shall be allowed as deductions: * * *
>
> "(m) Depletion. In the case of mines, oil and gas wells, * * * a reasonable allowance for depletion * * *. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *"
>
> "(n) Basis for Depreciation and Depletion. The basis upon which depletion, exhaustion * * * are to be allowed in respect of any property shall be as provided in Section 114."

Section 114, in force for the taxable periods here involved, insofar as pertinent, is as follows:

> "Section 114. Basis for Depreciation and Depletion. * * *
>
> "(b) Basis for depletion.
>
> "(1) General rule. The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection. * * *
>
> "(4) Percentage depletion for coal, * * *.
>
> "(A) In General. The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum * * * of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the

net income of the taxpayer (computed without allowance for depletion) from the property * * *."

Section 114 (b) (4) (B), as added by Section 124 (c) of the Revenue Act of 1943 (Act of February 25, 1944), effective as though it had been in the revenue laws applicable to all taxable years beginning after December 31, 1931, so far as pertinent, is as follows:

> "(B) Definition of gross income from property. As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining,' as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term 'ordinary treatment processes', as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; * * *"

(c) Date of Judgment Sought to be Reviewed.

The judgment sought to be reviewed was entered by the United States Court of Appeals for the Third Circuit on December 20, 1948. Petition for rehearing was filed January 4, 1949. Petition for rehearing was refused on January 13, 1949.

3. QUESTION PRESENTED.

Is petitioner, a lessee, entitled to deduct percentage depletion, in respect of income if derived during the taxable period from its extraction, cleaning, breaking, sizing, load-

ing and sale of coal from certain culm or refuse banks, where the said culm bank had been placed upon the surface of the mining tract by the lessor and its predecessors in title as a result of their coal mining operations conducted upon said tract in prior years?

4. REASONS RELIED UPON FOR THE ALLOWANCE OF A WRIT OF CERTIORARI.

(a) The United States Court of Appeals for the Third Circuit, in rendering a decision in the present case, has rendered a decision in conflict with decision of the United States Court of Appeals in the Ninth Circuit.

(b) The United States Court of Appeals for the Third Circuit has decided a Federal question in a way probably in conflict with applicable decisions of this Court.

5. PRAYER.

WHEREFORE, your petitioner prays that a writ of certiorari be issued out of and under the seal of this Court directed to the United States Court of Appeals for the Third Circuit, commanding that Court to certify and send to this Court, on a day certain to be named therein, a full and complete transcript of the record of the proceedings in case numbered 9630, October Term, 1947, entitled on its docket "Kohinoor Coal Company, Petitioner v. Commissioner of Internal Revenue, Respondent," to the end that the cause may be reviewed and determined by this Court as provided by law, that the judgment may be reversed with costs, and for such other and further relief as may be appropriately granted in the premises.

IN THE

SUPREME COURT OF THE UNITED STATES.

October Term, 194 .

No.

KOHINOOR COAL COMPANY,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The petition for writ of certiorari refers to the opinions of the United States Tax Court and the United States Court of Appeals for the Third Circuit, the grounds upon which jurisdiction is invoked, and the pertinent constitutional and statutory provisions. It also sets forth a summary statement of the matter involved and states the questions presented.

1. STATEMENT OF THE CASE.

There is no dispute as to the facts in the case, stipulation of facts (R. 10a-36a), notice of final determination (R. 4a-5a), appeal to the Tax Court (R. 2a-4a), the decision of the Tax Court (R. 10a), the petition for review to the United States Court of Appeals for the Third Circuit (R. 73a-76a), the decision of the United States Court of Appeals (R.) and the denial by that Court of petition for rehearing (R.).

The petitioner is a corporation organized under the laws of the State of Pennsylvania with its principal place of business located at Girardville, Pennsylvania. It filed its federal income and declared value excess profits tax returns and its excess profits tax returns for the fiscal years ended June 30, 1943, and June 30, 1944, with the Collector of Internal Revenue for the 12th District of Pennsylvania at Scranton, Pennsylvania (R. 10a).

During all periods of time herein mentioned petitioner was engaged in the business of extracting coal from certain culm or refuse banks (R. 11a).

Under date of February 11, 1941, the petitioner entered into a certain agreement of lease with Turkey Run Fuels, Inc. To extract the coal from said culm or refuse banks referred to in said agreement under the terms and conditions thereof, petitioner erected an anthracite breaker and installed other equipment which entailed a cost by petitioner of approximately $150,000.00 (R. 11a).

During the fiscal years ended June 30, 1943, and June 30, 1944, the petitioner was engaged in the operation of the leased culm or refuse banks, and prepared coal at a coal breaker (R. 11a).

For many years prior to June 30, 1943, the said culm or

refuse banks had been placed upon the surface of the mining tracts owned by Turkey Run Fuels, Inc. by the said lessor and its predecessors in title as the result of their coal mining operations conducted upon said tracts. Upon the execution of the aforementioned agreement of lease dated February 11, 1941, the Kohinoor Coal Company entered into occupancy of the said culm or refuse banks as lessee from Turkey Run Fuels, Inc. and commenced operations with respect to said culm or refuse banks in order to extract coal therefrom (R. 11a).

In filing its federal income tax return for the fiscal year ending June 30, 1943, petitioner claimed a deduction for percentage depletion, which was disallowed by the Commissioner, and in filing federal income tax return for the fiscal year ending June 30, 1944, petitioner attached a rider to said return setting forth therein that it elected to take depletion on a percentage basis, which deduction was denied by the Commissioner.

2. ARGUMENT.

Petitioner contends that under the law and various cases it is entitled to take a deduction for percentage depletion. Respondent denies that petitioner is entitled to the deduction for the following reasons: (a) It had no economic interest in the coal or culm banks; (b) the coal or culm banks do not constitute a mine; and (c) the removal of coal from a culm bank and the washing, breaking and sizing is not mining.

(a) In answer to the first contention, petitioner submits the Commissioner of Internal Revenue raised the same contention in the case of Lynch v. Alworths-Stephens Company, 45 S. Ct. Rept. 274, 267 U. S. 364. In that case a

lessee had the right to go in and remove ore deposits. The Commissioner contended title to the ore remained in the owner and lessor, and that the lessee was not entitled to any deduction for depletion because it had no economic interest in a mine. This Court stated:

"It is, of course, true that the *leases* here under review did not convey a *title* to the unextracted ore deposits, but it is equally true that such leases conferring upon the lessee an *exclusive possession* of the *deposits* and the *valuable* right of *removing and reducing* the ore to *ownership* created a *very real* and *substantial interest* therein. See Hyatt v. Vincennes Bank, 113 U. S. 408, 416, 5 S. Ct. 573, 28 L. Ed. 1009; Ewerth v. Robinson, 289 F. 740, 746-750. *And there can be no doubt that such an interest is property.* Hamilton v. Rathbone, 175 U. S. 414, 421, 20 S. Ct. 155, 44 L. Ed. 219; Bryan v. Kennett, 113 U. S. 179, 192, 5 S. Ct. 407, 28 L. Ed. 908. * * *

"While respondent does not own the ore deposits, its right to mine and *remove* the ore and *reduce it* to *possession* and ownership is *property* within the meaning of the general provision. Obviously, as the process goes on, this *property interest of the lessee in the mines* is lessened from year to year, as the owner's property interest in the same mines is likewise lessened. There is an exhaustion of *property* in the one case as in the other; and the extent of it, with the consequent deduction to be made, in each case is to be arrived at in the same way, namely, by determining the aggregate amount of the *depletion* of the mines in which the several interest in here, based upon the market value of the product, and *allocating* that amount in proportion to the interest of each severally considered." (Italics ours.)

The United States Supreme Court expressly held that a lease conferring upon the lessee exclusive possession and the valuable right of removing and reducing ore to ownership, created a very real and substantial interest therein.

The Commissioner again raised the question of economic interest in the case of Palmer v. Bender, 53 S. Ct. 225; 287 U. S. 551, and again the United States Supreme Court decided against the Commissioner, and expressly held that a lessee had an economic interest, and that the deduction was not to be confined to those who are technical lessors. The United States Supreme Court, in deciding against the respondent, stated:

> "It will be observed that the statute directs that reasonable allowance for depletion be made as a deduction in computing net taxable income, 'in the case of * * * oil and gas wells, * * * according to the peculiar conditions in each case.' The allowance to the taxpayer is not restricted by the words of the statute to cases of any particular class or to *any special form of legal interest* in the oil well. It is true that under article 215 of Treasury Regulations 62 the *lessor* of an oil or gas well is entitled to a depletion allowance upon the bonus and royalties received from the lessee. * * * But there is nothing in the statute or regulations which confines depletion allowances to those who are technically *lessors. The concluding sentence of the section that 'in the case of leases the deductions allowed by this* paragraph shall be equitably apportioned between the *lessor* and the *lessee'* presupposes that the deductions may be allowed in other cases." (Italics ours.)

The United States Supreme Court has, therefore, held that the right to remove something of value from the lands of another creates an economic interest. Under Pennsyl-

vania law, the lessee of coal lands or coal or culm banks becomes the absolute owner of the coal contained therein at the time of the execution of the so-called lease.

In the case of Boyle v. Coleraine Colliery Co., Appellant, 323 Pa. 224, the Court held that a lease of a culm bank with the right to remove coal therefrom, constituted a sale of the culm bank, and that the relationship of lessor and lessee did not exist. The Court stated, page 229:

> "In regard to the rails and ties found on the culm banks, these also were not located on the demised premises. The rights granted in regard to these banks by the letters of February 10 and February 17, 1930, while *purporting* to be a *'lease'*, constituted, in legal effect, under well established authorities, *a sale of the culm in place* to the extent removed by the grantee during the term, and the relationship between the parties as to such culm banks was therefore not that of lessor and lessee: Tiley v. Moyers, 43 Pa. 404, 410; Robinson v. Pierce, 278 Pa. 372, 375; Sturdevant v. Thomson, 280 Pa. 233, 236." (Italics ours.)

In the case of Smith v. Glen Alden Coal Company, et al., Appellants, 347 Pa. 290, the Court stated, page 298:

> "It is settled in this State that a lease of coal in place, such as this is, 'until such time as all the available merchantable coal shall have been mined and removed', is a sale of an estate in fee simple and leaves the lessor with only an interest in the royalties to be paid him under that lease. That interest is personalty. This conclusion is supported by the decisions of this court in Lillibridge v. Coal Co., 143 Pa. 293, 22 A. 1035; Kingsley, et al. v. Hillside Coal & I. Co., 144 Pa. 613, 23 A. 250; Sanderson v. Scranton, 105 Pa. 469; Hosack v. Crill, 18 Pa. Superior Ct. 90; Webber v. Vogel, 189 Pa.

156, 42 A. 4; Gilberton Fuels, Inc. v. P. & R. C. & I. Co., 342 Pa. 192, 20 A. 217 and many other cases * * *"

It is, therefore, respectfully submitted that the right to remove coal, oil, gas or minerals from the lands of another under United States Supreme Court decisions create an economic interest and that under a long line of Pennsylvania Supreme Court decisions a lease for a term of years, giving lessee a right to remove coal, constitutes a sale of the coal to the lessee and vests legal title in the lessee, and that under Pennsylvania law, a lease of a coal bank or culm bank with the right to remove coal therefrom constitutes a sale of the culm bank. Since Petitioner lessee has the exclusive right to remove and sell the coal from the coal bank, it believes that under the above decisions it is clearly possessed of an economic interest.

(b) The second contention of the Commissioner is that petitioner is not entitled to deduct percentage depletion because a culm bank is not a mine. The Commissioner reasons as follows: Section 23 (m) of the Internal Revenue Code provides for a deduction for depletion * * * in the case of mines, oil and gas wells * * *. Since a culm bank is not a mine, petitioner is not entitled to a deduction for percentage depletion. The Commissioner has been continuously raising this issue with little success until the United States Court of Appeals, in the case of Chicago Mines Company and in the present case, agreed with him in a manner expressly contrary to the decisions of this Court in the cases of Herring vs. Commissioner (1934), 293 U. S. 322, 55 S. Ct. 179, and Douglas vs. Commissioner (1944), 322 U. S. 275, 64 S. Ct. 988.

The question of whether or not a coal bank is or is not a mine or whether the removal of coal from a coal bank is mining has absolutely no connection or relation with the

present issue involved, as this Court decided in the Herring and Douglas cases, supra.

In considering the phrase "in the case of mines, oil and gas wells * * *", we immediately note that a mine is involved; that Turkey Run Fuels, Inc. is the owner of a coal mine.

The owner and lessor of the mining property is entitled to a deduction for percentage depletion. The culm banks and land overlying the coal mine are a part of the mining property. No distinction in substance can be drawn between raw coal that has been hoisted and dumped on the surface of the mining tract and raw coal lying in tunnels beneath the surface, or raw coal that has been moved through the tunnels to the foot of the shaft. It frequently happens that months and even years intervene between the time the coal is removed from beneath the surface of the ground and when the same is cleaned, broken, sized and sold. Underground mining operations may continue steadily throughout the year, coal or ore being piled in mountainous banks on the surface of the mining tract. In many localities the operators, "owners, or lessees, licensees, contractors" have only a few months during the summer to wash the coal or ore, streams being frozen and it being impossible to wash coal or ore during freezing weather.

The right to take a deduction for percentage depletion does not arise until the coal or ore is sold. When an owner of a mine, instead of preparing the coal for market himself, selects a lessee to clean, break and size the coal for sale, Sec. 23 (m) clearly states that the deduction for percentage depletion shall be equitably apportioned between the mine owner and the lessee. Capital is depleted when, and not until the coal is loaded on cars and sold. At this time the owner and lessee, by express statutory declaration, become entitled to a deduction for depletion. This Court, therefore, found that the words of the statute mean that a deduc-

tion for percentage depletion shall be allowed to owners of land under which lie mineral deposits, oil, gas, etc. This Court held that an oil well need not be sunk or a mine be in existence to entitle taxpayer to a deduction for depletion. The statute provides that when the owner enters into a lease of the mining property, the deduction for depletion shall be allocated between the lessor and the lessee.

In the Herring case, supra, the taxpayers owned a cattle ranch which they leased in 1926 for mining and operating for oil and gas. Upon execution of the lease in 1926, the taxpayers received $683,793.75 as a bonus or advance royalty upon which they claimed a deduction for depletion. At that time there were no wells on the leased lands and none within three and one-half miles from such lands, and it was not until four years later (1930) that any wells were drilled upon the leased land. The taxpayers claimed a deduction for percentage depletion in the year 1926 upon the amount of the bonus received, although there was no oil well in existence and no production from any oil well. Section 214 (c) (9) of the Revenue Act of 1926 granted:

> "In the case of mines, oil and gas wells, other natural deposits and timber, a reasonable allowance for depletion * * *."

Section 204 (c) (2) of the same Act provided for a deduction for percentage depletion, as follows:

> "In the case of oil and gas wells, the allowance for depletion shall be 27½ percentum *of the gross income from the property* during the taxable year. * * *" (Italics ours.)

The provisions of the 1926 Act are identical to the material provisions of Section 23 (m) and Section 114 (b). The

lessors claimed a deduction for percentage depletion upon the bonus received upon the execution of the oil lease.

The Commissioner contended that the statutory language which granted a depletion deduction, "in the case of * * * oil and gas wells," necessarily excluded a case where there was no well in existence and no production from any well. The court held that the fact that no well was in existence did not prevent the deduction, that a bonus or advance royalty is income from the property, and as such is a proper basis upon which to compute percentage deduction. The court stated:

> "A bonus is not proceeds from the sale of property, but payment in advance for oil and gas to be extracted, and is therefore taxable income. As such it is a part of the '*gross income from the property*' as the phrase is used in section 204 (c) (2) to designate the base for the application of the percentage deduction. From these premises the petitioners argue that the bonus received does not lose its character as income subject to depletion, merely because it happens that in the year of receipt there was no production of the depletable asset.
>
> "The respondent replies that the allowance for depletion is a matter of grace, not of right, and that the act fails to grant any allowance on income such as that there involved. The argument is that in both the relevant sections of the act, the statute says '*in the case of * * * oil and gas wells*' and this expression *necessarily excludes* a case where no *well exists*. In support of this asserted statutory exclusion it is urged that a depletion allowance is essentially and exclusively reimbursement for wastage or exhaustion of assets, and Congress could not have meant to permit an allowance in any year in which there was no extraction of

> oil or gas, and no practical assurance of production in the future. *We think these arguments cannot prevail to defeat the petitioner's right to the deduction.*" (Italics supplied.)

Following this quotation, the opinion sets out the Treasury's prior administrative views as to when and under what circumstances a percentage depletion deduction was allowable in regard to bonus payments and advance royalties, mentions the decisions of the Board of Tax Appeals, and then continues as follows:

> "The situation presented by the administrative rulings is this: A bonus is not a receipt from a sale of a capital asset and may not be returned as such; it is income in the year received; if any depletion is to be allowed against the receipt, the allowance must be claimed for the year of receipt; it cannot be allowed in any later year; if the taxpayer computed depletion upon the basis of cost on March 1, 1913 value he may deduct depletion from a bonus payment, irrespective of the sinking of a well or the production of any oil or gas; if, however, he elects to avail himself of the alternative method of computing deduction at a percent of gross income, though the nature of the deduction is unchanged, he may not have any unless there be production with the taxable year; if the production be but trifling he may take a full percentage deduction upon the entire bonus, however disproportionate the allowance to the actual extraction of oil during the year. To condition the allowance on actual production, however small, or the imminent probability of production, and to deal in refinements as to the degree of probability of future production as in many cases to deny any deduction where the taxpayer elects to compute

> it under section 204 (c) (2) (flat percentage of gross income from the property) and permit it where he elects to compute it under section 204 (c) (on the basis of cost). *But the nature and the purpose of the allowance is the same in both cases, and we find neither statutory authority nor logical justification for withholding it in the one and granting it in the other; much less for making the decision turn upon the circumstance that no production is obtained within the year in which the bonus is paid."* (Italics ours.)

The Supreme Court in the Herring case stated the test is: Was income received from the mining property? It specifically overruled the Commissioner's contentions that a mine must be in existence, and secondly, it must be producing. The Court held that a bonus is a part of the:

> " 'Gross income from the property' as the phrase is used in Section 204 (c) (2) to designate the basis for the application of the percentage deduction."

Since, therefore, it is immaterial whether or not a mine is in existence, the question becomes even less material as to whether or not a culm bank is a mine. Petitioner sold coal out of a culm bank which was part of a mining property. It paid royalties to the owner and lessor of the mine and culm bank. The interests of the lessor and lessee were depleted when the coal was removed and sold. The amounts of money received by the lessee constituted gross income from the property during the taxable year. The test laid down by the United States Supreme Court is: Was gross income received from the mining property during the year? The answer is, "Yes."

Section 114 (b) (4) (A) provides:

"(b) Basis for Depletion * * *

(4) Percentage depletion for coal * * *

(A) In General. The allowance for depletion under Sec. 23 (m) shall be, in the case of coal mines, 5 percentum * * * *of the gross income from the property* during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property * * *." (Italics ours.)

Respondent contends petitioner is not engaged in mining. This contention of the respondent was fully answered by this Court in the *Herring* case, supra, and also in the case of *Douglas v. Commissioner* (1944), 322 U. S. 275, 64 S. Ct. 988, 88 L. Ed. 1271, 32 AFTR 358. In that case the taxpayers owned a mine which they leased to Republic Steel Company on a royalty basis of 40 cents per ton, minimum royalties at $20,000 for five years, $60,000 a year thereafter. Lessee did not produce any ore. The Supreme Court reiterated the principle of the Herring case and held that lessors properly took a deduction for depletion over the years in which the minimum royalties were received. Neither the lessee nor the lessor was engaged in mining or producing ore. The rulings in the above entitled cases are, therefore, contrary to the Commissioner's contention in the present case.

The Commissioner raised the same question in the case of *Commissioner v. Kennedy M. & M. Co.*, 9th Cir. 125 Fed. (2) 399. In that case the Commissioner contended that income from the workings of a tailings dump was not income from mining. The tailings dump had been placed upon the surface of the land by the taxpayer many years previously. The Circuit Court stated, pages 400-401:

"The Commissioner contends that only so much of the taxpayer's income as was derived from newly

mined ores was income from the mine; and that, since no net income was so derived, no deduction for depletion was allowable.

"The Commissioner's contention must be rejected. The *tailings* from which the taxpayer derived part of its gross income and all of its net income during 1935 and 1936 were ores. They were ores from the taxpayer's mine, just as were the newly mined ores which the taxpayer treated in 1935 and 1936. *Income derived from the ores called tailings*, as well as that derived from the newly mined ores, *was income from the mine*.

"It is true, but not material, that the ores called tailings were mined prior to 1935. The mining of ores and the receipt of income therefrom are seldom, if ever, simultaneous. The two events are usually months apart and not infrequently years apart. Thus income from a mine during a taxable year may, and usually does, include income from ores mined prior to that year. * * *

"It is likewise immaterial that the subsequent treatment of these ores (in 1935 and 1936) was in a cyanide mill instead of a stamp mill. The right to deduct for depletion of a mine a percentage of the gross or net income therefrom does not depend upon the type of mill used in treating the ores from which such income was derived. Nor is the taxpayer's right to the deductions here claimed affected by the fact that, prior to 1934, it claimed and was allowed deductions for 'unit' depletion in accordance with Revenue Acts then in effect. Commissioner v. Elliott Petroleum Corp., 9 Cir., 82 F. (2d) 193.

"Atas Mining Co. v. Jones, 10 Cir., 115 F. (2d) 61, cited by the Commissioner, is not in point. The taxpayer in that case was a contractor which had contracted with the owner of a tailings dump to treat the tailings therein for a share of a proceeds. *Neither*

party to the contract owned any mine. The court held, and rightly so, that income resulting from performance of the contract was not income from a mine. (Italics ours.)

"Decision affirmed."

The Commissioner in the above case contended that income from the sale of ores removed from a tailings dump was not income from mining. The Court overruled the Commissioner and stated:

> "*Income derived from the ores called tailings* as well as that derived from the newly mined ores was income from the mine." (Italics ours.)

From the doctrine of this case income derived by petitioner from the sale of coal removed from a coal bank must be income from the mine.

In the case of *New Idria Quicksilver Mining Company v. Commissioner of Internal Revenue,* 144 Fed. (2) 918, the facts were as follows:

New Idria Quicksilver Mining Company purchased a metal mine on the surface of which was located an ore dump. The ore dump had been placed on the surface of the ground by a predecessor in title of *New Idria.* The *New Idria Company,* during the year in question, proceeded to remove the ore from the dump and process the same. It conducted no underground mining operations. The Circuit Court of Appeals decided against the Commissioner and held the *New Idria Company* was entitled to take a deduction for depletion on the ores removed from the ore dump and processed by it. The Court started at page 921:

> "The second question for determination is whether the New Idria Quicksilver Mining Company was entitled to claim percentage depletion on income derived

from *mining dumps* on its land. The ore in the dumps had been milled years previously, but with the improved furnacing process, it was possible to salvage some of the ore. The dumps had always been a part of the land and no depletion had ever been claimed. This Court in Commissioner of Internal Revenue v. Kennedy Mining & Milling Co., 9 Cir., 125 F. (2d) 399, 400, said that 'tailings * * * were ores. *They were ores from the taxpayer's mine, just as were the newly mined ores.*' The Tax Court failed to distinguish the instant case and the Kennedy case. *There is no legal distinction between the rights of the successor in interest and the rights of the original owner with respect to depletion claimed.* See also Consolidated Chollar, Gould & Savage Mining Co. v. Commissioner of Internal Revenue, 9 Cir., 133 F. (2d) 440." (Italics ours.)

As the Circuit Court stated:

> "There can be no legal distinction between the rights of the successor in interest and the rights of the original owner with respect to depletion claimed."

When petitioner entered into its agreement of lease with *Turkey Run Fuels, Inc.*, it became the successor in interest of the original owner and it acquired the rights of the owner to remove the coal from the culm banks.

(c) The third contention of the Commissioner is that the removal of coal from a culm bank, and the washing, breaking and sizing is not mining.

After various controversies as to the meaning of the term "mining," and as to the meaning of the term "gross income from property," Congress amended the Revenue Act of 1943 by adding subsection (B) thereto, which defined the

terms so that the Act now reads, Section 114 (b) (4) (A) (B):

> "A. The allowance for depletion under Section 23 (m) shall be in the case of coal mines, 5 percentum * * * of the gross income from the property during the taxable year. * * *
>
> "B. *Definition of gross income from property.* As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining' as used herein shall considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term 'ordinary treatment processes' as used herein shall include the following: (i) in the case of coal * * * cleaning, breaking, sizing and loading for shipment." (Italics ours.)

Congress, therefore, by statutory definition broadened the meaning of the word "mining" to mean not merely the extraction of ores or minerals from the ground, but in the case of coal the cleaning, breaking, sizing and loading for shipment.

> "The term 'mining' shall be considered to include * * * (i) in the case of coal * * * cleaning, breaking, sizing and loading for shipment."

Since petitioner is engaged in the business of cleaning, breaking, sizing and loading coal for shipment, it is engaged in mining by express statutory congressional definition.

The respondent in the present case relies upon *Atlas Mining Company v. Jones*, 10 Cir. 115 F. (2d) 61, but the Ninth

Circuit in *Commissioner v. Kennedy M. & M. Co.*, supra, properly stated:

> "Atlas Mining Co. v. Jones * * * cited by the Commissioner is not in point. The taxpayer in that case was a contractor which had contracted with the owner of a tailings dump to treat the tailings therein for a share of the proceeds. *Neither party to the contract owned any mine.*" (Italics ours.)

In the present case the lessor is the owner of the underlying mine and the coal in the culm banks was removed by the owner lessor and/or its predecessors and placed upon the surface of the mining tract. The Atlas case can, therefore, have no bearing upon the present situation.

Respondent also relies on the case of *Consolidated Chollar, Gould & Savage Mining Company*, 133 Fed. (2d) 440. The deduction for percentage depletion was denied to the taxpayer in that case because the ore dumps were not located on the mining premises whereas in the present case the coal banks are located on the surface of the mine from which the coal was removed.

Respondent also relies on the case of Helvering v. Bankline Oil Company, 303 U. S. 362, 366 (1938). The Bankline Oil Company neither owned nor operated any gas wells, neither was it lessor or lessee nor did it produce nor did it have the right to compel production of any gas. It was a processor. It purchased wet gas at the mouth of the well from the owners and operators. This Court stated, pages 367, 368:

> "(5) It is plain that, apart from its contracts with producers, respondent had no interest in the producing wells or in the wet gas in place. Respondent is a processor. It was not engaged in production. Under its contracts with producers, respondent was entitled

to a delivery of the gas produced at the wells, and to the extract gasoline therefrom, and was bound to pay to the producers the stipulated amounts. Some of the contracts, reciting that the producer was the owner of the gas produced, provided for its treatment by respondent. Other contracts were couched in terms of purchase. In either case the gas was to be delivered to respondent at the casingheads or gas traps installed by the producer. * * *"

This case can clearly have no application to the facts in the present case. The Bankline Oil Company purchased wet gasoline from various owners and operators, conveyed the said gas to its refining plant and converted the same into gasoline and illuminating gas. It suffered no depletion. It was not an owner of a gas well, an operator, a lessor or a lessee.

Since petitioner in the present case is a lessee in exclusive possession of a coal bank and engaged in removing said coal from the coal bank, and in cleaning, breaking, sizing, and loading the same for shipment, its case is controlled by Lynch v. Alsworth-Stephens Co., supra. and Palmer v. Bender.

3. CONCLUSION.

It is, therefore, respectfully submitted in summary:

(a) Petitioner is the owner of an economic interest in the coal contained in the culm banks (Lynch v. Allsworths-Stephens; Palmer v. Bender; Kirby Petroleum v. Commissioner, supra).

(b) It is immaterial whether or not a coal or refuse bank is a mine or whether the removal of coal from a coal bank

is mining, the only question being whether or not income was received from the property. The right to claim a deduction for percentage depletion does not depend upon the existence of a mine (Herring case, supra) nor does it depend upon whether or not the mine is in operation, nor upon whether or not underground extraction is taking place (Douglas case, supra, Kennedy case, New Idria case, supra).

(c) Washing, breaking and sizing coal is "mining" by statutory definition. In the Kennedy Mining & Milling Company case and the New Idria Quicksilver Mining Company case the Court found that the processing of tailings dumps constituted income from mining.

Accordingly, it is respectfully submitted that the record in this case presents a federal question of substance affecting the rights of owners and lessees of coal and metalic mineral properties throughout the nation, which question has been decided by the United States Court of Appeals for the Third Circuit in conflict with a decision of the United States Court of Appeals for the Ninth Circuit, and in a way probably not in accord with the decisions of this Court, and THAT THE PETITION FOR CERTIORARI SHOULD BE GRANTED.

Respectfully submitted,

JAMES J. DOUGHERTY,
JOHN R. SCHOLL,
Counsel for the Petitioner.